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CIO Weekly Commentary
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CIO VIEWS: STRATEGY AND PORTFOLIO CONSTRUCTION

Earnings season preview: revisionist history

Bottom line up top

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On behalf of Nuveen's Global Investment Committee

As Head of Equities and Fixed Income, Nuveen's CIO and leader of our Global Investment Committee, Saira drives market and investment insights, delivers client asset allocation views and brings together the firm's most senior investment leaders to deliver our best thinking and actionable investment ideas. In addition, she chairs Nuveen's Equities Investment Council and is a portfolio manager for several key investment strategies.

Corporate earnings are growing, but at a rate that's slowing. This coming Friday marks the unofficial kickoff to the S&P 500's third-quarter earnings season, giving investors an early glimpse of what will be an in-depth look at the health of corporate America. U.S. equity markets have continued to hit record highs throughout much of the year, fueled by economic resilience, easing inflation and Federal Reserve rate-cut expectations, which were realized last month. But whether 3Q earnings results can propel markets higher is an open question. Since the end of the second quarter, earnings per share (EPS) expectations for the S&P 500 have declined from +7.7% to +3.8%. And while eight of the 11 index sectors are still expected to show EPS growth for the third quarter, estimates for 10 of the sectors have seen declines — ranging from -0.4% for communication services to more than -20% for energy. The only sector to have its estimate raised is information technology at +0.5% (Figure 1).

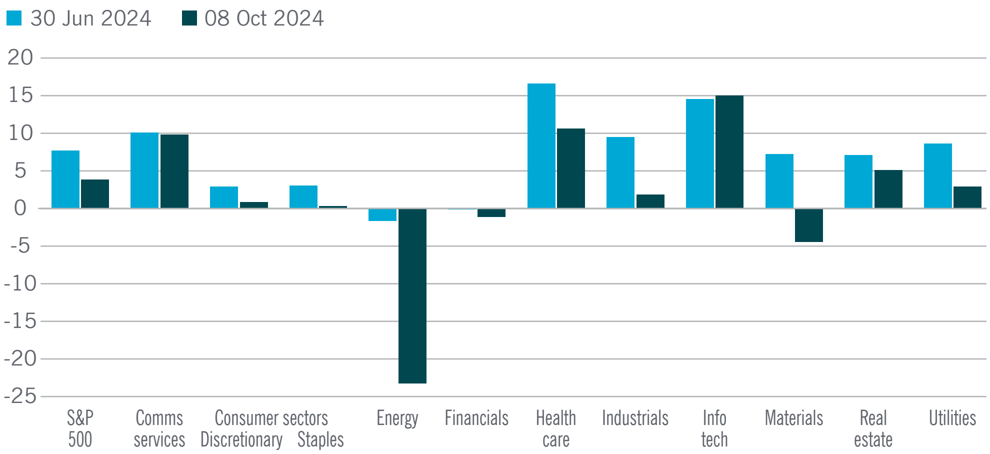
The main drivers of the downward revisions include falling oil and natural gas prices (an especially relevant headwind for the energy sector), sustained disinflation (broadly dampening revenues and margins) and tougher comparisons (as strong results from the previous quarter set a high bar for 3Q). This week we'll also get a peek at the impact lower interest rates may be having on corporate earnings — particularly for the largest U.S. banks and financial institutions, which report quarterly results first. With lower rates expected to crimp net interest margins, we could see EPS growth in the financials sector move even lower.

Slower corporate earnings growth could create a headwind for some areas of the equity market.

Volatility may rise on any geopolitical surprise. Decelerating earnings growth isn't the only potential headwind for equity investors. With the U.S. general election less than a month away and escalating hostilities between Israel and Iran, investors will likely have to contend with increased volatility over the next several weeks. Broader market indexes may experience pullbacks, but there are still pockets of attractive investment opportunities. But because we don't foresee a rising tide that will lift all boats on the horizon, we encourage investors to approach portfolio allocations with heightened selectivity.

FIGURE 1:U.S. EARNINGS GROWTH ESTIMATES HAVE TAKEN A HIT

S&P 500 earnings-per-share growth estimates (%)



Data source: FactSet, as of 08 Oct 2024. Data depicts the 12-month forward estimated EPS for the S&P 500 Index and individual sectors. **Past performance does not predict or guarantee future results.**

Portfolio considerations

After information technology and communication services, the bronze medal goes to … utilities? Year to date through 8 October, the S&P 500 is up +22%, with the "Magnificent 7" (Alphabet, Amazon, Apple, Nvidia, Meta, Microsoft and Tesla) contributing close to half of that gain. The information technology (+31.5%) and communication services (+29.4%) sectors have been the two biggest outperformers, though investors may be surprised to learn that the more defensive utilities sector isn't far behind (+28.6%). With utilities having posted positive returns in 10 of the past 12 months, the sector's one-year performance is now more than three standard deviations higher than its rolling one-year return over the past 10 years (Figure 2). We think the utilities rally may be overextended and that other sectors deserve focus.

The **health care** sector is lagging the overall S&P 500 by 9% year to date, even after several consecutive quarters of strong earnings. Although the healthy health care sector has been largely ignored, it remains one of our favorites, based on its defensive attributes and attractive fundamentals. In the medical technology (medtech) space, which includes medical devices, services and products for patient care and treatment, we favor higher-quality, sustainable growers. Medtech continues to benefit from burgeoning demand for elective procedures that had been delayed by the pandemic. We're also keeping a close watch on the medical tools category (instruments used for prevention, diagnosis or treatment of illness or disease) for its long-term potential. Slow biotech funding has been a headwind for these companies, but the market is beginning to garner interest again.

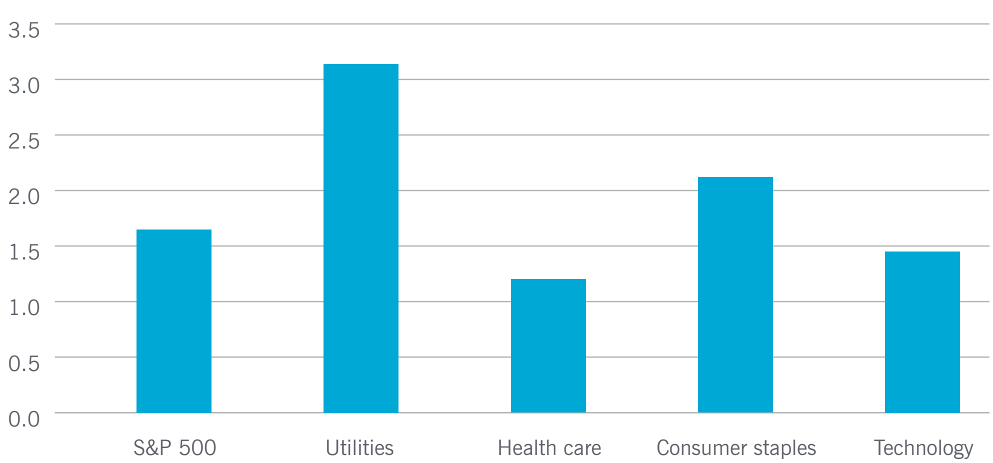
We continue to see value in the health care, technology and communication services sectors.

Although **technology** and **communication services** have been riding the wave of artificial intelligence (AI) euphoria for some time, we believe these sectors still have a long runway to outperform the broader market. Companies that supply the building blocks and infrastructure for AI should continue to attract strong demand. Semiconductors in particular will likely remain the primary beneficiary of, and participant in, AI's ongoing growth and evolution.

Software has underperformed in the tech rally, but the headwinds it faces are cyclical, not structural. The more the economy hints at a soft landing, the likelier it is that businesses will expand their IT budgets. This should help software companies grow their enterprise revenue. Lastly, while elevated interest rates have hampered the software industry, the Fed's recently launched easing cycle should turn interest rates into a tailwind.

FIGURE 2: THE UTILITIES SECTOR MAY BE OVEREXTENDED

S&P 500 10-year z-scores



Source: Bloomberg, L.P. 30 Sep 2014 to 30 Sep 2024. **Past performance does not predict or guarantee future results.** The z-score is a statistical measurement of how many standard deviations an element is from the mean. Z-scores here reflect rolling one-year returns of the S&P 500 Index and individual sectors over the past ten years using monthly returns.

About Nuveen's Global Investment Committee

Nuveen's Global Investment Committee (GIC) brings together the most senior investors from across our platform of core and specialist capabilities, including all public and private markets.

Regular meetings of the GIC lead to published outlooks that offer:

- macro and asset class views that gain consensus among our investors
- insights from thematic "deep dive" discussions by the GIC and guest experts (markets, risk, geopolitics, demographics, etc.)
- guidance on how to turn our insights into action via regular commentary and communications

For more information, please visit nuveen.com.

Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

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